

ANALYSIS OF AMENDED BILL

Author: Correa Analyst: Angela Raygoza Bill Number: SB 1337

Related Bills: See Legislative History Telephone: 845-7814 Introduced Date: February 20, 2008
 Amended Date: April 1, 2008

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Limited Liability Companies/Contractors

SUMMARY

This bill would allow contractors to form limited liability companies (LLC's).

SUMMARY OF AMENDMENTS

The April 1, 2008, amendments would modify the Corporations Code to allow an LLC to render services pursuant to a license, certificate, or registration *only* if the LLC is licensed, certified, or registered under the Business and Professions Code.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide flexibility in estate planning, profit sharing, and liability protection for the personal assets of owners of construction businesses.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative on and after January 1, 2009.

POSITION

Pending.

ANALYSIS**FEDERAL/STATE LAW**

The Beverly-Killea Limited Liability Company Act (LLC Act) first authorized the organization of LLC's in California in 1994 and also recognized LLC's organized under the laws of other states. An LLC is a hybrid form of an unincorporated business entity affording its members certain benefits, such as the following:

- ◆ Limited liability to the extent of a member's equity investment,
- ◆ Flexible management alternatives and,
- ◆ Liberal membership qualification requirements.

Board Position:

☐ S ☐ NA ☐ NP
☐ SA ☐ O ☐ NAR
☐ N ☐ OUA ☒ PENDING

Department Director

Date

Brian Putler
for Selvi Stanislaus

4/8/09

Members of an LLC are afforded the same advantage of limited liability as shareholders of a corporation. If an LLC is classified as a partnership for income tax purposes, the income of the LLC is generally subject to only one level of income tax, as are the partners of a partnership.

LLC's treated as partnerships for income tax purposes are not subject to the membership restrictions or the two levels of income tax imposed on S corporations.

Current federal and state law allows eligible business entities including LLC's to be treated as partnerships, corporations, or entities that are disregarded for federal tax purposes. Generally, the classification of a business entity for California purposes is required to be the same as the entity's federal classification. LLC's not classified as a corporation that are organized, registered, or doing business in California are required to pay an annual tax of \$800 and a fee measured by total income attributable to California.

Current state law allows domestic or foreign LLC's to engage in any lawful business except banking, insurance, trust company business, or the offering of professional services for which a license, certification or registration is required, unless expressly authorized under provisions of the Business and Professions Code or the Chiropractic Act.

"Professional services" is defined in the Moscone-Knox Professional Corporation Act (Corporation Act) as any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, or the Osteopathic Act. "Professional services" also means any type of professional services that may be lawfully rendered pursuant to a license, certification, or registration authorized by the Yacht and Ship Brokers Act.

PROGRAM BACKGROUND

Until 2004, the Office of the Secretary of State (SOS) prohibited businesses licensed under the Business and Professions Code from forming LLC's. In 2004, SOS requested an Attorney General (AG) opinion asking if "a business that provides services requiring a license, certification, or registration pursuant to the Business and Professions Code [could] conduct its activities as [an LLC]." AG Opinion 04-103 concluded that a business could "conduct its activities as an LLC if the services rendered require only a nonprofessional, occupational license." The AG declined to determine if each licensed activity specified in the Business and Professions Code was a professional or a nonprofessional occupational activity. SOS no longer denies any application, professional or non-professional, on the basis that the business is licensed under the Business and Professions Code.

THIS BILL

The bill would allow a contractor to form as an LLC with the SOS. In addition, the bill would authorize the issuance of a contractor's license to an LLC under the Business and Professions Code.

Under this bill, any LLC would be treated in the same manner as a corporation relative to the issuance, renewal, suspension, re-issuance, or termination of a license.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

LEGISLATIVE HISTORY

AB 2235 (Parra, 2005/2006) would have expanded the definition of "person" under the Real Estate Law to include an LLC. This bill failed passage in the Senate Judiciary Committee without being heard.

SB 1022 (Campbell, 2005/2006) sought to authorize the formation of professional LLC's to provide professional services, as defined. This bill failed passage in the Senate Judiciary Committee

AB 2724 (Runner, 2001/2002) would have authorized a contractor's license to be issued to an LLC that met certain requirements. That bill failed passage out of the Assembly Business and Professions Committee.

AB 2401 (Miller, 1995/1996) would have provided that an LLC may not render professional services, unless the LLC is expressly authorized under the applicable provisions of the Business and Professions Code or the Chiropractic Act or is a real estate broker licensed under the real estate licensing law. This bill failed passage out of the Senate Business and Professions Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York allow contractors to form a LLC if the members are registered, licensed, or certified by that state or local licensing entity.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this bill was estimated as follows:

Estimated Revenue Impact of SB 1337 Effective for Tax Years BOA 1/1/2009 Assumed enacted after 6/1/2008 (\$ in Millions)			
2008-09	2009-10	2010-11	2011-12
+\$2	+\$6	+\$9	+\$13

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill would be estimated as the difference in the tax revenue collected under existing and proposed laws. Under existing law, nearly all licenses issued by the State Contractors' License Board are for individuals. Individual contractors must file returns with the FTB to pay taxes on their contractors' business income. An LLC often elects treatment as a partnership for tax purposes. As such, an LLC must pay a minimum tax of \$800, must pay a fee based on its total income, and must pass through its profit or loss to its owners. The profits are taxed to the individual and the losses are deducted. It is assumed if the individual contractor converts to an LLC that taxes on an individual contractor's business income under existing law is equal to taxes on an owner's pass-through profits. Thus, the revenue impact of this bill would be equal to the taxes and fees paid by the new LLC's that would be created by this bill. The impact was estimated in several steps.

First, data from the Contractors' State License Board was merged with 2005 tax return samples to identify individual contractors with income reported on a Schedule C. Only building and specialty trade contractors were considered for this analysis.

Next, the potential LLC taxes and fees to be collected were estimated assuming that all individual contractors would convert into LLC's. Based on the above data from the State Contractors' License Board and FTB tax returns, this potential amount was estimated at \$111 million for 2005. This number is further adjusted to account for (1) the conversion rate from individual contractors to LLC, (2) missing data, (3) contractors other than building and specialty trade contractors may convert to LLC, and (4) percentage of individual contractors who learn about this bill. Based on the above assumptions, the net impact of this bill was estimated to be a revenue gain of approximately \$4.5 million for the 2005 taxable year ($\$111 \text{ million} \times 6\% \text{ conversion rate} \times 1.61 \text{ for missing data} \times 1.05 \text{ for other contractors} \times 40\% \text{ 1st year participation} \approx \4.5 million).

The estimated 2005 revenue impact was extrapolated to future years assuming an annual growth rate of 2%. The revenue impact for the 2009 taxable year was estimated to be approximately \$5 million.

Finally, the tax year estimates were converted to fiscal year estimates shown in the above table. For example, the revenue gain for the 2008-09 fiscal year is estimated at approximately \$2 million because of lower participation in the first year. This amount comes from estimated payments that are equal to the minimum tax of \$800. The 2009-10 estimate of a revenue gain of \$6 million includes a \$4 million gain from the 2009 tax year, plus \$2 million gain from the 2010 tax year.

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